Incrementum Inflation Signal Indicates a Sharp Decline of the Inflation Momentum – The End of the First Inflation Wave

Dear investors, advisory board members and friends,

We hereby want to inform you that as of beginning of July, **our proprietary inflation indicator has decreased from a "50% RISING INFLATION" to a "50% FALLING INFLATION" signal and thus reached the minimum level for the first time since November 2018.**

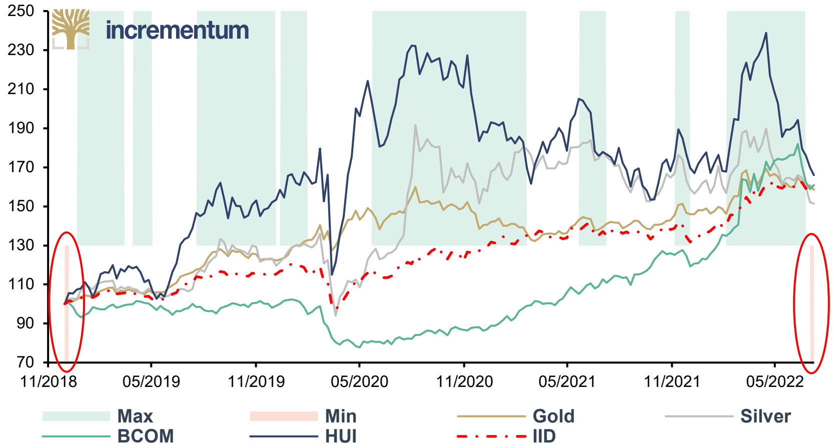
Surfing the Wave

In line with the broadly rising inflation trend indicated by our signal since the last minimum expression in November 2018, **inflation-sensitive assets have performed exceptionally**. While commodities initially suffered from the consequences of the COVID-19 measures (lockdowns, travel restrictions, etc.), prices gradually recovered and were clear outperformers among inflation-sensitive assets.

A further accelerant for the historically high inflation momentum was then revealed in February 2022 with the outbreak of the war in Ukraine and the sanctions implemented in this context. Both commodities and gold as a crisis currency and, as a consequence, mining stocks and other precious metals benefited from the developments in Eastern Europe at the beginning. However, this momentum rapidly subsided in recent weeks and is **now transitioning to a strongly disinflationary regime**. This is also shown by our signal: Only three weeks ago, the Incrementum inflation signal showed the maximum strength. However, the trend reversal is not surprising and is much more **due to the stagflationary environment, which goes hand in hand with increased inflation volatility**.

Overall, the first wave of inflation was very successful for our fund. Since the last minimum signal at the end of November 2018, the performance is **60.3% (EUR-I)**. Inflation-sensitive assets performed to a comparable extent (gold 58.4%, silver 51.3%, BCOM 61.0%, HUI 66.1%), albeit with significantly higher volatility.

Inflation-Sensitive Assets, in EUR, IID (EUR-I), 11/2018 = 100, and Incrementum Inflation Signal (Max- and Min-Level), 11/2018-07/2022

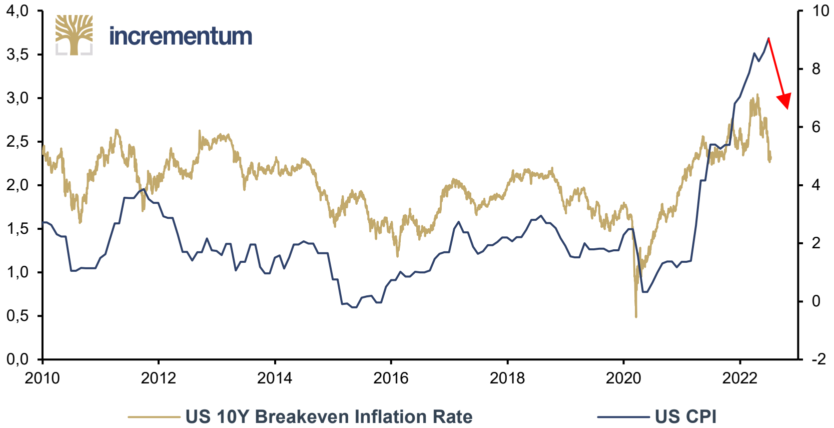


Source: Reuters Eikon, Incrementum AG

Taking a Break

In addition to our inflation signal, several factors currently point to a disinflationary environment. First, the **US 10-year breakeven inflation rate has been declining for several months**. Usually, the CPI rate follows with a slight lag, as can be seen from the following chart. For another, we have seen a **decline in the core rate of US inflation already since April**.

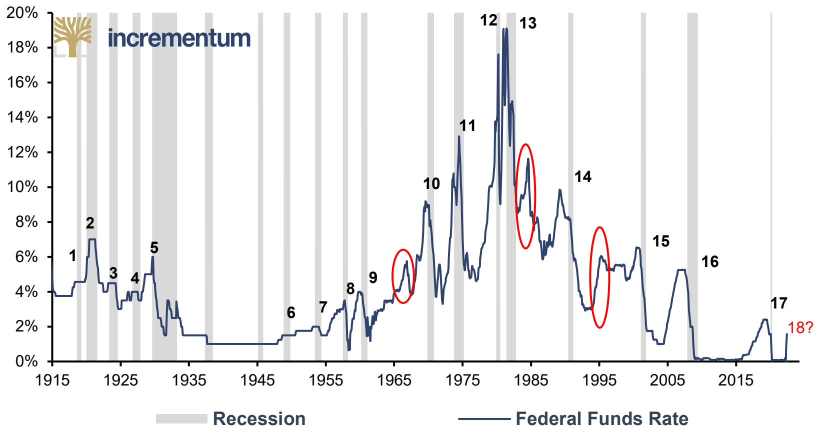
US 10Y Breakeven Rate (lhs), in %, and US CPI (rhs), in %, 01/2010-07/2022



Source: Reuters Eikon, Incrementum AG

The demand-driven slowdown caused by high inflation figures and rising interest rates is also leading to a significant deterioration in the economy. The following chart shows that so far **only three out of 17 interest rate hike cycles have not resulted in a recession**. Given the precarious economic situation, we do not expect to see a fourth exception to this "rule".

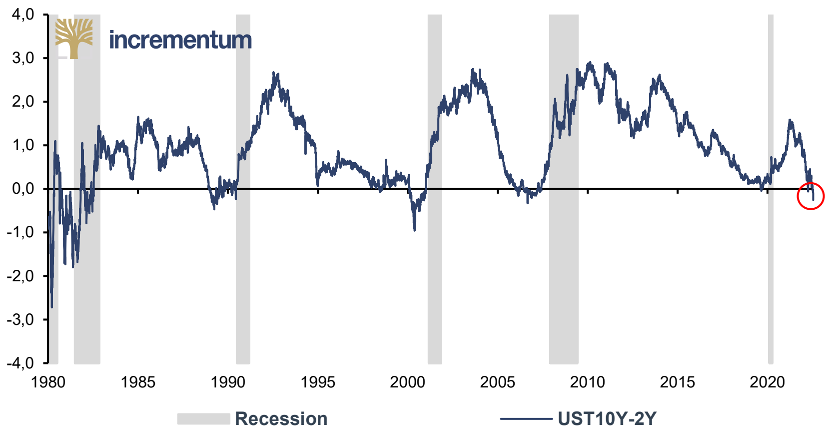
Federal Funds Rate, 01/1915-06/2022



Source: Reuters Eikon, Incrementum AG

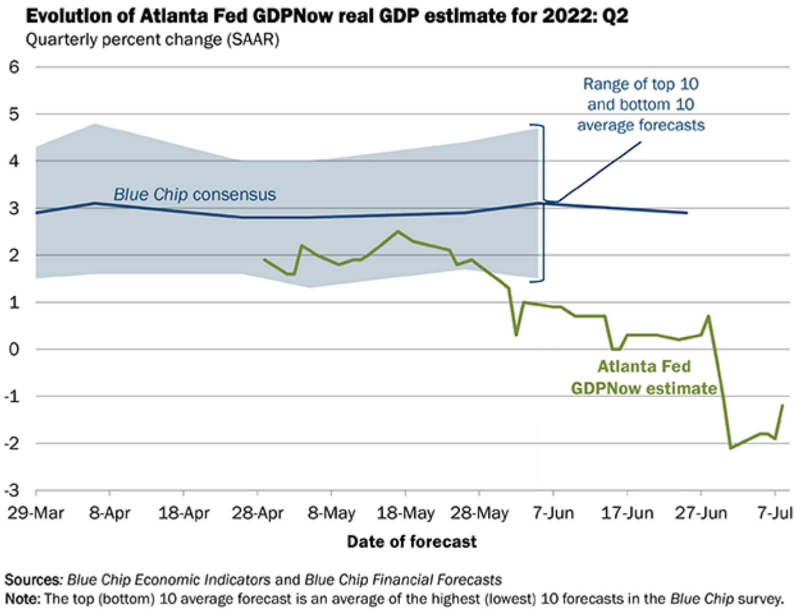
The recent inversion of the yield curve, which serves as a very reliable recession indicator, reinforces this thesis.

US Yield Curve Inversion (UST10Y-2Y), in %, 01/1980-07/2022



Source: Reuters Eikon, Incrementum AG

Politicians are currently doing what should be avoided at all costs in a stagflationary environment. Namely, intervening in the market with monetary and fiscal policy. The restrictive monetary policy measures are causing an even faster and more drastic slowdown in economic activity, further reducing disposable household income and triggering even stronger fiscal policy measures, which are easy to justify from a political and socioeconomic point of view, but in turn have an inflationary effect and are often not designed efficiently, such that the costs of these policies exceed the benefits.

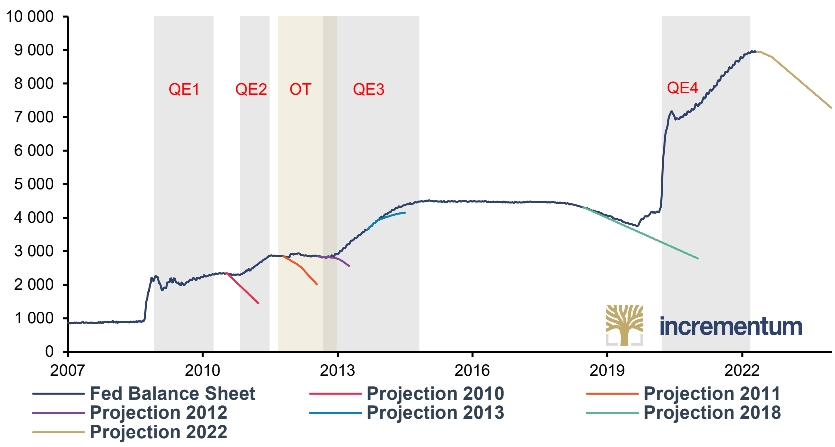


As of July 8th, the GDPNow model estimates a decline in real GDP growth in the second quarter of -1.2 percent. **If this number materializes, it would send the U.S. into a recession** after having already contracted in the first quarter of this year, although an official recession would not necessarily be recognized by the U.S. due to its own recession methodology designed by the NBER.

The Next Inflation Waves Are Still Out There

The depicted macroeconomic developments will most likely exert downward pressure on inflation in the short-term. However, the Fed will face more headwind for its restrictive monetary policy as soon as the second negative GDP quarter in a row is written, which is why **we expect further waves of inflation in the medium-term**. Another observation that supports this thesis is the fact that the Fed usually cuts rates when the ISM trades below 50. Currently, all components of the ISM are clearly slowing – ISM could cross 50 by July or August already!

Fed Balance Sheet Path, in USD bn, 01/2007-01/2024e



Source: Reuters Eikon, Federal Reserve, Incrementum AG

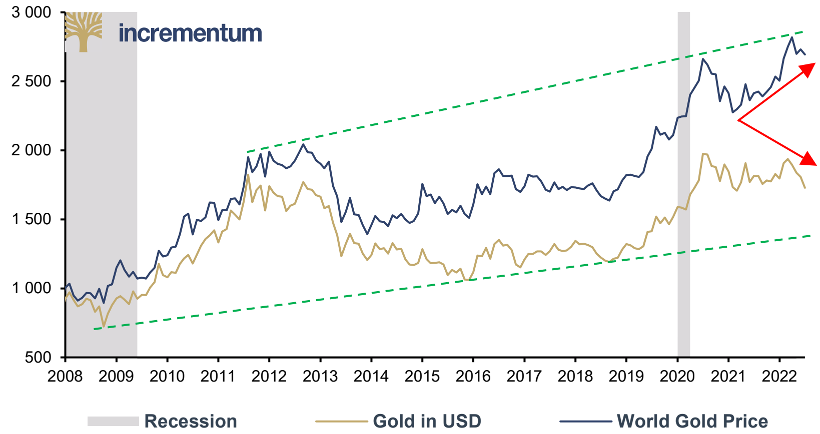
Since the Great Financial Crisis of 2008/09, the Fed communicated a reduction of its balance sheet five times so far. The implementation looked somewhat different. In all cases the Fed had already cancelled its QT program just after a few months with exception of the last QT, where the Fed was able to implement almost half of the planned balance sheet reduction. Now the sixth QT program is in process – one breath away from a recession. We strongly doubt that the Fed will manage to reduce the planned USD 522.5 bn. in 2022 and USD 1,140 bn. in 2023. Together with the tight rate hike cycle, **this would be the most aggressive monetary tightening since Paul Volcker**.

Instead, we see an imminent reversal in the monetary policy stance forthcoming, which will lead to a stop in further rate hikes and at least the stop of QT, if not the beginning of a new QE programm. Togetehr with the persistence of supply chain issues, an uncertain Zero-Covid policy in China, and the numerous bottlenecks due to the war in Ukraine this will get us **perfect weather for the next inflation wave**.

Implications for Gold

With the recent performance of the gold price, it is worth taking a fragmented view. While the performance of gold in USD terms has been disappointing in recent months, gold managed to hold up reasonably well in this difficult environment, especially compared with other asset classes.

Gold Price, in USD, and World Gold Price, in USD, 01/2008-07/2022



Source: Reuters Eikon, Incrementum AG

Even though some headwinds are still to be expected in the short-term, a more positive environment for gold is emerging in view of the monetary policy and macroeconomic developments described above. In particular, the **price development in USD should provide significant relief in the event of a turnaround by the Fed**.

Year	USD	EUR	GBP	AUD	CAD	CNY	JPY	CHF	INR	Average
2000	-5.3%	1.2%	2.4%	11.2%	-1.9%	-5.4%	5.8%	-4.2%	1.4%	**0.6%**
2001	2.4%	8.4%	5.3%	12.0%	8.8%	2.4%	18.0%	5.5%	5.8%	**7.6%**
2002	24.4%	5.5%	12.3%	13.2%	22.9%	24.4%	12.2%	3.5%	23.7%	**15.8%**
2003	19.6%	-0.2%	8.0%	-10.7%	-1.3%	19.6%	8.1%	7.4%	13.9%	**7.2%**
2004	5.6%	-2.0%	-1.7%	1.5%	-2.0%	5.6%	0.8%	-3.1%	0.1%	**0.5%**
2005	18.1%	35.2%	31.6%	25.9%	14.1%	15.1%	35.9%	36.3%	22.8%	**26.1%**
2006	23.0%	10.4%	8.1%	14.3%	23.3%	19.0%	24.2%	14.1%	20.7%	**17.5%**
2007	30.9%	18.4%	29.2%	18.0%	12.0%	22.5%	22.5%	21.8%	16.9%	**21.4%**
2008	5.4%	10.0%	43.0%	30.5%	28.7%	-1.5%	-14.2%	-0.8%	30.0%	**14.6%**
2009	24.8%	21.8%	13.0%	-1.6%	7.9%	24.8%	27.9%	21.1%	19.2%	**17.6%**
2010	29.5%	38.6%	34.2%	13.9%	22.8%	25.1%	13.2%	16.8%	24.8%	**24.3%**
2011	10.2%	13.8%	10.6%	9.9%	12.7%	5.2%	4.5%	10.7%	30.7%	**12.0%**
2012	7.1%	5.0%	2.4%	5.3%	4.2%	6.0%	20.7%	4.5%	11.1%	**7.4%**
2013	-28.0%	-30.9%	-29.4%	-16.1%	-23.0%	-30.1%	-12.6%	-29.8%	-19.1%	**-24.3%**
2014	-1.8%	11.6%	4.4%	7.2%	7.5%	0.7%	11.6%	9.4%	0.2%	**5.6%**
2015	-10.4%	-0.2%	-5.3%	0.6%	6.8%	-6.2%	-9.9%	-9.7%	-5.9%	**-4.4%**
2016	8.5%	12.1%	29.7%	9.4%	5.3%	16.1%	5.4%	10.3%	11.4%	**12.0%**
2017	13.1%	-0.9%	3.3%	4.6%	5.9%	6.0%	9.0%	8.3%	6.3%	**6.2%**
2018	-1.5%	3.0%	4.3%	9.0%	6.8%	4.1%	-4.2%	-0.8%	7.3%	**3.1%**
2019	18.3%	21.0%	13.8%	18.7%	12.6%	19.7%	17.2%	16.6%	21.3%	**17.7%**
2020	25.0%	14.7%	21.2%	14.1%	22.6%	17.2%	18.8%	14.3%	28.0%	**19.5%**
2021	-3.6%	3.6%	-2.6%	2.2%	-4.3%	-6.1%	7.5%	-0.6%	-1.7%	**-0.6%**
2022YTD	-5.6%	6.9%	7.4%	1.4%	-2.7%	-0.1%	12.3%	1.6%	0.7%	**2.4%**
Average	**9.1%**	**9.0%**	**10.7%**	**8.5%**	**8.2%**	**8.0%**	**10.2%**	**6.7%**	**11.7%**	**9.1%**

Source: Reuters Eikon, Incrementum AG

Investment Impact

After the signal initially declined from 1 to 0.5, we have already positioned ourselves more defensively in order to be prepared for the event of a further decline. Now that our proprietary signal has dropped to the lowest level, we have built up our long duration position with US bond futures. In addition, we currently hold a short position on the Nasdaq 100 future. On the commodity side, we will refrain from going short in the near future – which we usually do when the signal indicates a disinflationary environment – due to the uncertanties amid the Ukraine war.

With our inflation signal as a leading indicator, we are preparing for the next wave of inflation already. Many of the companies and assets that we follow trade at very attractive valuation levels currently and we will be **conducting dozens of company meetings over the upcoming weeks in order to separate the wheat from the chaff.**

Ladies and gentlemen, we believe it is illusory that the Federal Reserve can deprive the market of the “punchbowl” for any length of time, and we seriously doubt that the transformation of doves into hawks will last. Most hawks will merely turn out to be doves in hawk’s clothing and will shed their hawkish stance sooner rather than later as a result of the inevitable consequences of monetary tightening: recession, rising yields, stock market corrections, bankruptcies, unemployment.

We believe that the market is coming closer panic lows for inflation-sensitive assets. As soon as the Federal Reserve is compelled to deviate from the planned course we expect the rally to continue and new all-time highs to be reached. For the time being, we remain cautious in regard to the general commodity sector, but we are constantly updating our watchlists and prepare for the next move.

We are also very proud to announce that, as of mid July, the **Incrementum Inflation Diversifier Fund is among the top 5 funds worldwide both on a 3- and 5-year basis in the category Alternative UCITS - Multi Strategy** listed on citywireselector.com.

We are here for you and will be happy to take the time to talk to you about your investments. Do not hesitate to call or write us if you have any questions and/or suggestions.

Best regards and above all good health to you and your beloved ones!

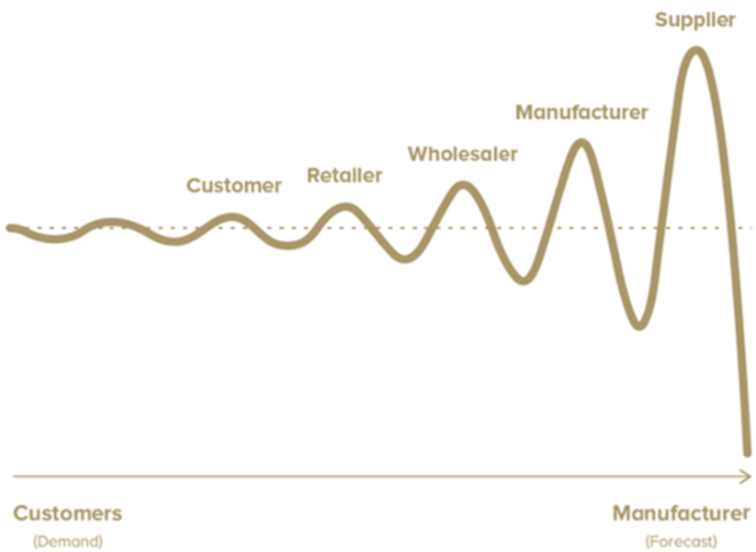
Sincerely yours,

Ronald-Peter Stoeferle and Mark J. Valek

One for the road

An explanation why disinflation is imminent and we will experience several waves of inflation is provided by the bullwhip effect. According to this economic phenomenon every supply shock or spike in demand ultimately leads to excess orders such that prices decrease, because supply does not find demand. Those excess orders magnify on the business chain starting at the customer level and ending at the supplier level. Typically the bullwhip effect takes place between phases of QT and QE.

More on the bullwhip effect can be learned here: https://www.youtube.com/watch?v=Dq35iX18GX0



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